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UNCLAS SECTION 01 OF 02 MANILA 003421

SIPDIS

SENSITIVE

STATE FOR EAP/PMBS, EAP/EP, EB/IFD, EB/TPP/BTA/ANA  
STATE PASS USTR FOR BWEISEL AND DKATZ  
STATE PASS USAID AND OPIC  
TREASURY FOR OASIA FOR AJEWELL  
USDOJ FOR MCRAWFORD  
USDOC FOR 4430/ITA/MAC/DBISBEE

E.O. 12958: N/A

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SUBJECT: PHILIPPINE FINANCIAL MARKETS POST-SONA

REFS: A) Manila 3397, B) Manila 3370

[11.](#) (U) Summary: Peso, stock, and bond markets have not reacted negatively to President Arroyo's State of the Nation Address on July 25. Her promise to forge ahead with economic and fiscal reforms, whatever the political cost, helped send a positive signal (Ref A). The stock market closed firmer on July 26 (Tuesday) after a three-day weekend capped by President Arroyo's SONA. The peso closed at 56.00 pesos/\$1, down only slightly despite hovering political uncertainties and seasonally stronger foreign exchange demand. Rates for Treasury bills softened during the GRP's weekly dealers' auction on July 26 and sovereign spreads for medium-term foreign debts tightened. The business community will continue to watch the president and her new economic team closely for signs that they are implementing reforms and competently governing. End Summary.

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IT WAS OK  
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[12.](#) (SBU) According to local traders and analysts, markets were relieved that pro- and anti-Arroyo rallies during President Arroyo's July 25 State of the Nation Address (SONA) were generally orderly and peaceful. Many local analysts considered her speech neither awe-inspiring nor entirely disappointing. Although lacking in details, one brief statement did strike a cord -- her assurance that her Administration would not waver in its commitment to economic reform and fiscal discipline "whatever the political cost." For now, markets appear to be willing to give her the benefit of the doubt, although the situation remains volatile as the political impasse drags on. Many in the business community are cautiously optimistic that her endorsement of charter change will further calm the political waters and allow her maneuvering room to solidify economic reforms -- most importantly, to improve tax collection -- in the near term.

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SHARE PRICES CLOSE FIRMER  
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[13.](#) (U) The Philippine Stock Price Index (Phisix) closed July 26 at 1,959.58, up 0.3% from the July 22 close of 1,954.40 (the most recent trading day because of the holiday on July 25 for the SONA). At that level, the Phisix was up 3.9% from the end of May 2005 (before the audio tapes linking President Arroyo to alleged election fraud surfaced) and up 7.6% from year-end 2004. The Phisix hit an intra-day high of 1,966.50 as investors continued to purchase selected stocks ahead of second-quarter profit reports, but profit taking retracted some of the Phisix's earlier gains. Dealers had expected some investors to cash in on profits after the Phisix rallied more than 3% during the July 18-22 trading week. After four consecutive trading days of net foreign purchases totaling 1.5 billion pesos, July 26 saw a modest amount of net foreign sales (10 million pesos). Foreign net purchases from July 1 through July 26 totaled 224.2 million pesos.

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T-BILL RATES SOFTEN  
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[14.](#) (U) Rates for 91-day bills inched up by 18 basis points to 5.632% during the GRP's weekly dealers' auction on July 26. The increase was not unexpected after the average rate for the 91-day paper dropped by more than 72 basis points on July 18 to its lowest level since September 2003. The average rate for the 182-day paper softened by 3 basis points to 7.401% (a three-week low) and by 6.5 basis points for the 364-day bills to 8.417%.

As of July 26, the average 91-day Treasury bill rate was 28.8 basis points lower than at the end of May 2005 and 215.8 basis points lower than at the end of 2004. The average rate for the 182-day paper was down 43.5 and 147.6 basis points from end-May 2005 and end-December 2004, respectively. As of July 26, the average rate for the 364-day paper had increased by 43.2 basis points from the end of May 2005 but had declined by 130.8 basis points from the end of 2004.

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CURRENCY BACK TO 56 PESOS/\$1 ON STRONG FOREX DEMAND  
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15. (U) For the first time since mid-July, the local currency again hit the 56 pesos/\$1 mark during inter-bank trades on July 26. It opened at 55.85 pesos/\$1, hit an intra-day high of 55.79 pesos, and closed at 56.00 pesos, 0.2% weaker than its previous close on July 22. At July 26's closing rate, the peso was down 2.7% (1.48 pesos) from the end of May 2005; and was 0.5% (0.28 pesos) stronger than at the end of 2004. As expected, the yuan's revaluation late last week has had little effect on the peso because of hovering political uncertainties, heavier corporate demand for end-of-month foreign exchange obligations, and the onset of the seasonally-high third quarter import season.

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Sovereign Bond Spreads Tighten for Medium-term Maturities  
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16. (U) On July 25, sovereign bond spreads narrowed for medium-term Philippine bonds maturing in 2008 and 2010 but widened somewhat for longer-term foreign debt instruments. Spreads for Philippine bonds maturing in 2008 and 2010 closed 152 and 316 basis points, respectively, above comparable U.S. Treasuries, tightening from the previous close of 155 and 321 basis points. Spreads for debts maturing in 2019 and 2025 widened to 463 and 507 basis points, respectively, from 460 and 504 basis points last Friday. As of July 26, the respective spreads for the 2008, 2010, and 2019 bonds were 51, 23, and 5 basis points narrower than at the end of May 2005 and, for the 2025 bonds, 3 basis points wider. Compared with end-December 2004, spreads for these four bond maturities had tightened by 127, 84, 44, and 13 basis points, respectively.

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Comment  
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17. (SBU) President Arroyo seems to have reassured economic interests with her pledge to stay the course on reform. In the weeks and months ahead, the business community will continue to watch the president and her new economic team closely to see if she can demonstrate the political will to move forward with reforms as she struggles for political survival. For now, however, most are choosing to cautiously back her and her new economic team. For many, this support may be a default position because palatable alternatives are hard for them to envision.

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